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SUBJECT: ETHIOPIA'S HIDES, SKINS AND LEATHER SECTOR

11. SUMMARY: The hides, skins and leather (HSL) sector is a priority area in the Government of Ethiopia's (GoE) economic development plan. While Ethiopia has the potential to produce large amounts of very high-quality leather, problems of poor quality inputs, over-capacity in tanneries, and a low starting base are challenges to sector expansion. The U.S. Government and other donors are offering technical assistance to assist growth in HSL production and quality improvement, with promising results to date. END SUMMARY.

A FOCUS FOR GOE'S POVERTY REDUCTION PLAN

12. Ethiopia's Plan for Accelerated and Sustained Development to End Poverty (PASDEP), a five-year plan covering 2005-2009, targets the leather and leather products industry as key to raising export income and reducing poverty. The PASDEP targets the leather, leather products and shoe sectors with a goal of increasing export revenue to USD 500 million by 2009/2010. According to statistics provided by the National Bank of Ethiopia, the value of leather and leather products exported rose from USD 52.2 million in 2002/3 to USD 89.6 million in 2006/7, a 71.6% increase. Leather is currently the fifth leading export from Ethiopia following coffee, oilseeds, gold and chat.

PROGRESS BEING MADE, CHALLENGES REMAIN

13. Following the GoE's declared focus on leather and leather products, the international donor community responded with programs to assist. USAID's Agribusiness and Trade Expansion Project, for example, is partnering with the Ethiopian Leather Industries Association (ELIA) with a goal of increasing exports by 70%. This project aims to improve the quantity and quality of leather by restructuring the value chain, increasing the quality of raw stock, enhancing value added production, and expanding market outreach.

14. Other donor-funded projects include the "Made in Ethiopia" project led by the United Nations Industrial Development Organization (UNIDO), which has assisted in the formation of the TAYTU brand of high-end, high-fashion handbags. This month, Addis Ababa is the venue for the All Africa Leather Fair, expected to expose thousands of buyers to Ethiopian leather. Although early results of assistance are positive, with joint efforts lending to a 19% increase in leather exports in 2006/7, challenges remain to further expansion.

QUALITY INPUTS

15. With one of the largest livestock herds in the world, Ethiopia has a vast potential in HSL. Ethiopia's cattle herd is 7th largest (20 million), its sheep herd is 9th largest (24 million), and its goat herd is 8th largest (18 million) in the world. Moreover, the highland environment is amenable to producing thick, dense skins and the Ethiopian variety of sheep skins is also renowned

internationally for its dense fiber texture and elasticity which makes top quality gloving leather. Roughly 60% of the world's finest sheep skins for gloves come from Ethiopia and the name "Bati Genuine" has been coined by the international leather market for high quality goat skins after the Ethiopian province of Bati where animals of this variety are raised.

¶16. Despite the large number of animals, Ethiopia's tanners face difficulty in obtaining high-quality, undamaged raw materials. This is due to a number of factors in the supply chain. First, almost no professional slaughtering is done in Ethiopia. Most animals are slaughtered for meat consumption, primarily around major religious holidays. The "slaughter boys" and rural farmers are not trained in butchering and skinning, and as a result the skins are often damaged at the time of skinning. (NOTE: Technically a hide is from cattle and skins are from sheep and goats. This cable will use the term "skin" for all types of animals. END NOTE.)

¶17. After slaughter, the skins face an extensive journey to the tannery. In rural areas, families take the skin to the nearest market town where it is sold to a trader. When the trader has a donkey-load of skins, they are taken to a larger town. There, another trader will purchase the donkey-load and wait until he has a truck-load. The truck-load of skins (still unpreserved through this point) is then taken for sale to a tannery. The time from slaughter in a rural area to delivery to a tannery can be up to two months, during which the skins can deteriorate significantly. Urban slaughter cuts transit time to approximately one week, but given Ethiopia's highly rural population, very little urban slaughter takes place proportionally.

¶18. An additional challenge to quality supply is the presence of skin diseases such as ecto-parasite, known locally as Ekek, that degrade the skin. Currently, there is no incentive paid by traders or

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tanneries for quality, undamaged skins -- the price is solely based on the size of the skin. These factors lead to over 50% of skins being rejected at the tanneries. Additionally, there are defects in some skins that cannot be detected until the tanning process is at least partially finished.

TANNERIES AND TRADE REGIME

¶19. There are currently 26 tanneries in Ethiopia employing nearly 5,000 people. One tannery is owned by the GoE and managed by Pittards Limited of the UK under a five year management contract, while all others are privately owned and operated. The total capacity for processing is 28 million hides and skins per year, and a 2002 study estimated that the tanneries are operating at about 65% capacity for skins (sheep and goat) and 80% capacity for hides (cows). The primary reason for operating below capacity is lack of quality raw skins for input.

¶110. The export of unprocessed skins is currently prohibited under a law dating to the communist Derg regime. Most factories are producing semi-processed leather (at the pickle, wet blue, and crust stages) at the request of their customers. The semi-finished product is exported to European and Asian countries for finishing and production. The GoE is moving aggressively to promote higher-level in-country processing. In January, the Ministry of Finance and Economic Development (MoFED) got approval from the Council of Ministers to impose an export tax on semi-processed leather in a further effort to promote finished leather. The tax still needs Parliamentary approval, but recommendations by the Council of Ministers are widely followed. However, the chairman of the Ethiopian Leather Industries Association (ELIA) questioned the ability of companies to effectively respond to this "incentive" since upgrading tanneries to produce finished leather requires huge investments.

¶111. According to the senior trade attorney on USAID's WTO Accession Plus project, this export tax will apply to both unprocessed and semi-processed skins. From a WTO accession standpoint this is a positive move, as it replaces a more restrictive quantitative

measure with a less-restrictive one that still addresses Ethiopia's pursuit of value addition. However, MoTI and MoFED argued that lifting the ban on unprocessed skins at a time when tanneries are already facing severe supply shortages could lead to the closure of up to half of Ethiopia's tanneries, as happened in Uganda and Kenya when similar measures were taken.

BUT WHAT DOES THE CUSTOMER WANT?

¶12. Despite the challenges cited above, Ethiopia produces some of the best quality leather in the world. Why, then, is most of the product exported as semi-processed? Simply put, it is the current preference of the customer. By purchasing Ethiopia's strong, supple skins at a semi-processed stage, foreign manufacturers are able to apply proprietary techniques, processes, and dyes to produce a unique finished product. While the British company Pittards has begun finishing shoe leather in-country, most customers prefer to finish in other locations including Japan and Italy. Ethiopia does offer a cost savings in terms of labor, but Pittards has found that while their labor cost is only USD 1 million per year, productivity is only one-third that of their UK workers.

¶13. COMMENT: Given the country's vast livestock and labor resources, Ethiopia's emphasis on HSL as a priority sector is logical, and the GoE is dogged in its pursuit of growth in the production of finished leather. With the right conditions, Ethiopia could become a world-leading center for finished leather and leather goods production, and some experts argue that it is poised to do so in the immediate future. However, the recently proposed tax increase on semi-processed leather may dampen progress in the sector if neither tanneries nor customers are ready to make a fast leap. Additionally, if the export ban on unprocessed leather is lifted, tanneries may not have enough input to continue operation. Donor programs such as USAID's which focus on improving the value chain and upgrading tannery capacity are making strides. As quality and consistency of the end product and awareness of Ethiopian leather grows in the world market, the country should reap rewards in increased foreign exchange revenue. END COMMENT.

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